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SUBJECT: ROMANIA: CONTROVERSY OVER OFFSHORE ENERGY CONCESSIONS
FOLLOWING ICJ DECISION

Sensitive but Unclassified; not for Internet distribution.

SUMMARY

¶1. (SBU) Romania's initial euphoria after prevailing over Ukraine in a Black Sea boundary dispute has given way to political finger-pointing over offshore energy concessions. The International Court of Justice (ICJ) in a February 3 ruling awarded Romania exclusive rights to 3,745 square miles of the Black Sea's continental shelf. A media circus followed when it was revealed that the government had conceded oil and gas exploration rights for much of the zone years ago on apparently very favorable terms to the concession holders. The controversy has centered on a small Canadian company, Sterling Resources, and how it came to be a major player on Romania's newest oil and gas frontier. Particularly controversial is the murky process that allowed a Government production-sharing agreement involving multiple companies to turn into a royalty-based agreement with just one company without any public transparency. End Summary.

¶2. (SBU) The unanimous ICJ ruling on February 3, 2009 awarded Romania an exclusive economic zone (EEZ) of 9,700 square kilometers (3,745 square miles) of the continental shelf abutting Romania in the Black Sea. The area had been the object of a 40-year-old boundary delimitation dispute, initially with the Soviet Union and later with Ukraine. Unable to reach an agreement through bilateral negotiations, Romania sued Ukraine in September 2004 at the ICJ. Romania asked the Court to rule on the delimitation of the continental shelf and the exclusive economic zones belonging to Romania and Ukraine in the Black Sea. The final ruling awarded Romania approximately 80 percent of the area in dispute.

¶3. (SBU) Romanian officials were quick to announce plans for exploiting possible oil and gas reserves in the area. Initial statements by the Romanian National Agency for Mineral Resources (NAMR) estimated possible reserves of up to 100 billion cubic meters of natural gas and 10 million tons of oil in the area awarded to Romania. If these estimates prove accurate, offshore oil and gas would increase Romania's natural gas reserves by 50 percent and oil reserves by 15 percent, helping to offset the accelerating depletion of onshore oil and gas fields.

¶4. (SBU) Media reports surfaced quickly, however, that most of the surface area awarded to Romania was already under the control of Petrom (owned by OMV of Austria) and a little-known company called Sterling Resources (Canada). (Comment: While the media is reporting that only half of the surface area has been deeded to these two companies, the companies' publicly declared holdings would actually amount to 80 percent. End Comment). Petrom's concession agreements cover 40 percent of the newly delimited area, while Sterling holds the other 40 percent. Until the ICJ decision, Petrom and Sterling were prohibited from actually operating in the disputed area. They now appear poised to ramp up exploration activities quickly in light of the settlement.

THE HISTORY OF ROMANIA'S PETROLEUM LAW

¶15. (SBU) Until 1995, the Romanian oil and gas sector operated under a Petroleum Law first passed in 1942. During the communist regime, the state awarded exploration and production contracts for oil and gas to state-owned entities. At the time, Rompetrol was in charge of natural gas imports, offshore exploitation, and overseas oil and natural gas activities. Petrom was primarily focused on domestic onshore oil and gas production and distribution. Both before and after 1989, Petrom was awarded concessions entailing the right to explore, develop and operate over 300 onshore fields. In 2000, Petrom, which was still state-owned, expanded into the offshore arena by acquiring two offshore blocks: XVIII-Istria and XIX Neptun directly from the Romanian State without any public tender.

¶16. (SBU) In 1992, Romania opened its oil and gas sector to foreign investment and mandated that state-owned Rompetrol negotiate and conclude partnership agreements for offshore oil and gas exploration and development. In 1992, Rompetrol, Enterprise Oil Exploration, and Canadian Oxy signed an Exploration and Production Sharing Agreement (EPSA) for the XIII Pelican and XV Midia XV blocks, with a total surface of 4,119 square kilometers (1,590 square miles). Under the EPSA, Rompetrol was entitled to an in-kind share of up to 40 percent of the production. In 1993, Rompetrol was privatized, and the National Agency for Mineral Resources (NAMR) replaced the company as the Government of Romania (GOR) entity in the EPSA. Through transfers, mergers, ownership changes, and acquisitions, the parties to the EPSA have changed. Sterling Resources first became a party to the EPSA in 1997 and has increased its interest from an initial 16.67 percent, to 20 percent in 2000, and then to 100 percent in 2006. Throughout this entire period the underlying agreement has remained intact, but has been modified and extended through amendments on multiple occasions.

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PSA MORPHS INTO A ROYALTY-BASED CONCESSION

¶17. (SBU) As time passed and the parties to the EPSA changed, ten amendments -- each extending the initial exploration period -- were negotiated between the companies and the NAMR. However, the basic framework of the EPSA remained unchanged until 2007. In August 2007, Sterling Resources and the NAMR signed an eleventh amendment, transforming the Production Sharing Agreement into a royalty-based Concession Agreement for Exploration, Development and Production. The royalties were set according to the percentages stipulated in the 2004 revisions to the Petroleum Law, i.e. a maximum royalty of 13.5 percent. On November 11, 2008, the Tariceanu Cabinet passed Government Decision 1446, approving the amendment. Many local legal experts are questioning the validity of this 11th amendment, which seems to have replaced the original 1992 contract in its entirety.

A NEW PETROLEUM LAW

¶18. (SBU) In 2002, arguing that steady cash royalties were more reliable than shared production for budgeting purposes, the Nastase Cabinet passed Emergency Ordinance 42/2002, changing all of the pre-existing PSAs into concessions. This ordinance stated that royalties were to be paid in cash, and set up percentages pro-rated against the output of the field, with a maximum percentage of 13.5 percent of the value of the output. In addition, to bolster the sale of Petrom to OMV in 2004 and to provide legal grounds to extend the length of pre-existing concessions (an OMV priority), the Nastase Cabinet conducted a wholesale revision of the Petroleum Law.

As revised, the law formally established the provisions and percentages regarding oil and gas royalties, while also allowing concessions to be extended for an extra 15 years at the conclusion of the initial 30-year period. Passed at the same time as the law sanctioning Petrom's privatization to OMV, the law further stipulated that the GOR could not change the level of royalties until after 2014.

OFFSHORE TODAY

¶19. (SBU) Today, Romania has two companies holding concessions to

explore, develop, and extract offshore oil and gas. One of the companies, Petrom, is currently operating two Black Sea offshore blocks (XVIII Histria and XIX Neptun), covering an area of 13,800 sq km (5,328 square miles). Petrom also operates four productive fields (East Lebada, West Lebada, Sinoe and Pescarus) and has one field under development (Delta). According to data released by Petrom, its current offshore production is approximately 31,000 barrels of oil equivalent (boe) per day, which represents 26 percent of Petrom's total production. In December 2008, Petrom entered into an agreement with Exxon Mobil to cooperate in exploring the hydrocarbon potential of the deepwater portion of the Neptun Block. The Neptun Block covers an area of approximately 9,900 square km (3,822 square miles), with water depth ranging from 50 meters (164 feet) to 1700 meters (5,577 feet).

STERLING RESOURCES CONTROVERSY

¶10. (SBU) The new cabinet of Prime Minister Emil Boc is scrutinizing the agreement with Sterling, and seeking legal grounds to abrogate Amendment 11, as the terms now appear unfavorable to the Romanian state. Underlying the public furor is skepticism regarding the exact terms of the original 1992 contract, which was classified by the GOR and has yet to be released, as well as serious questions about how it morphed into a royalty agreement, advantageous to the company. Sterling is defending its case, claiming the amendments did not grant Sterling any additional rights and that, despite a reference to the eastern and northern boundaries of its concession in one of the amendments, it has not received rights to any additional surface area. Former Prime Minister Calin Popescu Tariceanu is aggressively defending his record in the matter, accusing the new Government of creating a scandal purely for political gain and announcing a lawsuit against the GOR for slander.

Sterling says it has so far invested \$56 million in offshore exploration (seismic surveys and drilling) since 1997. Sterling also announced that in light of the ICJ ruling it would ask the NAMR to lift the suspension of exploration activities which had been in place for 3,865 square kilometers (1,492 square miles).

¶11. (SBU) It is still unclear what the full economic stakes are, since reserve estimates based on seismic data have not been confirmed for the entire area of the two blocks. Exploratory wells drilled by Sterling at three sites in undisputed areas struck gas in two fields, Doina and Ana. Sterling estimates the natural gas volume in the Doina and Ana fields to be 6 billion cubic meters, with a recovery rate of up to 80 percent, depending on the equipment used. Should the gas resources be commercially exploited, Sterling estimates that it would require a 450 million USD investment in

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order to start production in 2011-2012. It would also require an additional investment of 80 million USD in a 130-kilometer pipeline to bring the gas onshore and connect it to the national gas grid.

COMMENT

¶12. (SBU) Black Sea oil and gas have the potential to contribute significantly to Romania's energy security. It is essential, however, that Romania be able to attract the investment and technology required for offshore operations in a clear and transparent manner. The existing, non-transparent oil and gas concessions are not an encouraging first step. Notwithstanding possible legal challenges, the way the Sterling contract was drastically changed through an amendment, rather than a new public tender, creates the appearance that a sweetheart deal was done for the company. Not helping Sterling from a public relations perspective is the recently-discovered ownership link between the company's largest shareholder and the controversial Rosia Montana gold-mining venture. This connection has fed media speculation that certain investors in both projects may be unfairly trying to exploit Romania's natural resources for personal gain. Of note, however, is the lack of media controversy and the absence of GOR statements surrounding an equivalently large area leased to OMV-Petrom, on what appear to be similarly favorable terms. It seems that the GOR is consciously avoiding reopening the Pandora's box of Petrom privatization, including the terms for Petrom's offshore concessions, by focusing all the public ire on the smaller Canadian

competitor. End Comment.